As Foreign Investment Leaves, Canadian Ownership Grows

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For the past 70 years, there has been substantial foreign investment in Canadian upstream oil and gas. In part, this is because only 20 per cent of the world's oil reserves are open to private development and half of those reserves are in Canada. But foreign investment in the industry has come and gone over the years with the ebbs and flows of economic nationalism and – more recently – uncompetitiveness of investments in Canadian oil and gas compared to opportunities elsewhere.

Restrictions on Foreign Investment

Canada has historically welcomed foreign investment, with two notable exceptions. The first was the measures taken after the rapid escalation of foreign ownership of Canadian businesses in the 60s, including in the oil and gas industry, which had become American-controlled following decades of foreign investment with no federal government review required. In response, the *Foreign Investment Review Act (FIRA)* was passed in 1973, aimed at restricting foreign investment in Canada. As part of the program to counter the growth of foreign ownership of Canada's oil and gas industry, PetroCanada was created in 1975 and the National Energy Program (NEP) was introduced in 1980. These and other measures were successful in increasing the levels of Canadian ownership in the oil and gas industry.

When opposition to foreign investment subsided in the 1980s, steps were taken to attract investors back into the Canadian oil and gas industry, including:

- replacing *FIRA* with *the Investment Canada Act (ICA)* in 1985, (which narrowed the focus of and streamlined the foreign investment review process);
- eliminating the NEP and restrictions on foreigners acquiring Canadian oil and gas companies; and
- ultimately privatizing PetroCanada.

These changes cleared the path for a new wave of foreign investment in the Canadian oil and gas industry, particularly by state-owned-enterprises (SOEs). From 2000 to 2012, billions were spent on acquisitions of Canadian oil and gas companies by SOEs from China (CNOOC, PetroChina, Sinopec, China Investment Corp), Abu Dhabi (TAQA), Norway (Statoil), Thailand (PTT Exploration), Korea (Korean National Oil) and Malaysia (Petronas). Frequently, the targets owned Canadian oilsands projects. This acquisition binge climaxed in 2012 with Petronas's $5.5B purchase of Progress Energy and CNOOC's $15.1B purchase of Nexen.

However, the magnitude of the oilsands businesses acquired by SOEs during this period caused the Canadian government to conclude (after approving the CNOOC/Nexen transaction in December 2012) that SOEs' control of oilsands development had reached the point where further acquisitions of control by SOE's would only be allowed in exceptional circumstances. This resulted in the second notable restriction on foreign investment, being the changes to the SOE Guidelines to limit further oilsands acquisitions and to impose other restrictions on SOEs' M&A activities in Canada.

Foreign Investment Declines

Since those changes to the SOE Guidelines, no significant acquisitions of oilsands or other Canadian upstream oil and gas properties by foreign entities, including SOEs, have occurred except for Repsol's acquisition of Talisman in 2015 and for assets sold together with interests in proposed LNG export projects.

Further, new capital investment by existing foreign investors on proposed oilsands projects was deferred or cancelled after oil prices collapsed in 2015 and, in July of this year, Petronas and the other sponsors of the Pacific NorthWest LNG export complex cancelled that project.

Foreign Capital Exits

More importantly, substantial amounts of foreign capital started to exit the Canadian oil and gas industry beginning in 2016. International oil companies, including ConocoPhillips and Murphy Oil (US), Mitsubishi (Japan), Shell (Netherlands), Statoil (Norway) and Harvest (Korea) sold significant parts of their Canadian oil and gas investments to Canadian companies.

The exodus accelerated in the first half of 2017, with ConocoPhillips selling oilsands and other assets to Cenovus for $17.7B, and Shell and Marathon (US) selling oilsands assets to Canadian Natural Resources for $12.7B. Other recent foreign sellers include Apache (US) and Centrica (UK).

These sales have, for the most, part been driven by international oil companies redeploying their capital to more profitable opportunities elsewhere. Canada's environmental and fiscal regimes, high costs of labour and materials, and difficulties in executing export projects were likely among the factors considered in the decisions to sell those Canadian properties.

Canadian Ownership Increases

One result of this latest reversal of foreign investment has been the significant increase in Canadian ownership of our resources, particularly in the oilsands. TD Securities estimated that following this exodus of foreign capital, Canadian control of the country's oil (conventional and oilsands) and natural gas production grew to 84 per cent and 71 per cent, respectively, with Canadian control of producing oilsands assets increasing to 82 per cent from 67 per cent.

These are dramatic increases compared to the 25 per cent to 30 per cent levels of Canadian ownership in the 70s.

Opportunities for New Investments

Notwithstanding the flow of foreign investment out of the Canadian oil and gas industry, some parts of the Canadian energy sector could continue to attract foreign capital:

- The Montney is one of the few plays in Canada that is competitive with the Permian and other shale plays in the US. Petronas, Shell, Repsol, Chevron and other international oil companies have properties there. Petronas in particular confirmed its commitment to developing its Montney assets, notwithstanding the cancellation of the Pacific Northwest LNG project.

- Foreign investors including private Chinese and American investors have recently participated in various transactions involving midstream assets. Investment activity in that part of the Canadian energy sector should continue, with the gathering, transportation, processing and petrochemical facilities required in the Montney being particularly active.

- The LNG export projects proposed for development on the West Coast were virtually all sponsored by foreign investors, including some SOEs. The largest of those proposed export projects have satisfied most, if not all, of the regulatory requirements in order for them to proceed. A small export project owned by Woodfibre is expected to be under construction shortly. Although the Pacific NorthWest LNG project has been cancelled, sponsors of the other large projects are still considering their final investment decisions. Recently, Shell confirmed that it and the other sponsors of the LNG Canada Project (Mitsubishi, PetroChina and Korea Gas) continue to work on lowering costs and getting the timing right. Decisions to proceed would result in substantial foreign investment in order to build and operate these projects.

- There are also opportunities for foreign investors in Canadian renewable energy projects. Saskatchewan recently committed to increase renewables to 50 per cent of its generation capacity by 2030. Alberta committed to retire its coal fired generation by 2030 and replace it with a combination of renewables and natural gas. Renewables are to make up 30 per cent of the power produced in Alberta by 2030, with at least 5,000 megawatts of renewable generation capacity to be procured. Alberta estimated that $10.5B in new investment will be required. Procurement processes underway in both Saskatchewan and Alberta have seen significant interest from foreign participants. Five of the eight qualifying bidders in SaskPower’s recent process for 200 megawatts of utility-scale wind capacity are foreign owned.

Conclusion

The challenge for Canada will be to implement changes that will make these and other opportunities in our energy sector attractive once again to foreign and domestic investors alike.

Resources

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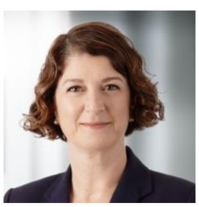

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